APPENDIX A

Internal Revenue Code of 1954, § 7201 (26 U.S.C. § 7201):

§ 7201. Attempt to evade or defeat tax

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution. Aug. 16, 1954, 9:45 a.m., E.D.T., c. 736, 68A Stat. 851.

APPENDIX B

[Filed Nov. 12, 1964]

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

LR-64-CR-29

UNITED STATES OF AMERICA, *Plaintiff*,
v.
JOHN S. FOWLER and JIMMIE LEA FOWLER, *Defendants*.

Memorandum Opinion

After a jury trial which consumed several days the defendants in this case, John S. Fowler and Mrs. Jimmie Lea Fowler, his wife, were found guilty on a three count indictment charging criminal violations of the federal income tax laws. The indictment charged in substance that with respect to calendar years 1957, 1958, and 1959 the defendants knowingly and wilfully and with the intent to evade and defeat substantial portions of their income tax liabilities for those years filed or caused to be filed with the District Director of Internal Revenue at Little Rock,

Arkansas, joint income tax returns for said years, which returns were false and fraudulent in that each return substantially understated the true taxable income of the taxpayers and substantially understated the income taxes due from the defendants, 26 U.S.C.A., § 7201.

At the close of the Government's case and at the conclusion of all of the evidence, the defendants moved for judgments of acquittal. Those motions were not granted and, as indicated, the jury found the defendants guilty on all counts of the indictment. The defendants have now moved, pursuant to Rules 29(b) and 33 of the Federal Rules of Criminal Procedure, 18 U.S.C.A., that the verdicts of the jury be set aside and that judgments of acquittal be entered, or that in the alternative the Court grant a new trial. The Government resists the motion.

Prior to the filing of the motion the Court had directed the defendants to appear for sentence at 1:30 P.M. on November 9, 1964, and the defendants so appeared in person and by counsel. At the commencement of the proceedings on the date last mentioned the Court announced from the bench that defendants' motion would be overruled as of that time, and that sentences would be imposed as scheduled. The Court also stated that in the course of the week it would file a formal memorandum dealing with said motion. The Court now does so.

In support of the renewed motions for judgments of acquittal the defendants assert that "the evidence contained in the record is insufficient to sustain a conviction on any count of the indictment as to either defendant." The Court does not agree.

The evidence disclosed that prior to and during the indictment period the defendants resided in North Little Rock, Arkansas; that they derived income from the Broadway Motel in that city, from other small motels and hotels, and they had other sources of taxable income. The Government, proceeding under the net worth plus non-deductible

expenditures method of proof, introduced substantial evidence from which the jury could well have found, and evidently did find, that for each of the tax years in question the defendants' taxable income was understated very substantially, and in view of the essential simplicity of the defendants' business operations the jury had a right to infer, and plainly did infer, that the understatements were not due to ignorance, inadvertence, negligence, or misconception as to the requirements of the tax laws, but were knowing and fraudulent, and were made for the unlawful purpose of evading or defeating substantial portions of their tax liabilities which true and correct returns would have disclosed to be due.

Without stopping to go into detail the Court is convinced that the Government met the technical requirements of the net worth method of proof, or that the jury could have found that those requirements were met. This is to say, the jury could have found from the evidence beyond a reasonable doubt that defendants' net worth at the beginning and end of each of the indictment years had been established with a reasonable degree of certainty; that during each of the years involved the defendants had sources of taxable income; that defendants' net worth increased substantially each year; and that the increases were not attributable to non-taxable sources such as loans, gifts, bequests, or accumulations from prior years. The jury also had a right to find from the evidence that the agents of the Government made reasonable investigations into the affairs and holdings of the defendants during relevant periods of time, and made reasonable investigations of "leads" suggested by the taxpayers. In such circumstances the jury had the right to draw the inference that the increases in net worth were attributable to taxable income and the jury had a right to infer that defendants' non-deductible expenditures of funds represented income.

The Court is also persuaded that to the extent that the Government was required to corroborate by independent

evidence admissions made by the respective defendants or their accountant in the course of the investigation or at other times, the Government introduced sufficient corroborative proof.

Not only is the Court convinced that the jury had a sufficient evidentiary basis for convicting both defendants on all counts of the indictment, the Court is also convinced from the evidence which it heard in the course of the trial that the defendants in fact were guilty.

Turning now to the alternative motion for a new trial, defendants contend first that the Government relied in large measure upon extra-judicial statements of one defendant or the other, made at various times, and that the admission of evidence as to those admissions and the permitting of the Government to rely thereon violated the so-called "husband-wife privilege."

Generally speaking, the privilege invoked by defendants is that, aside from any question of the competency of one spouse as a witness for or against the other, a spouse will not be permitted to testify, over the objection of the other, as to any confidential communication which passed between the spouses. McCormick On Evidence, Hornbook Series, § 82. While some courts limit the privilege to direct written or oral communications between husband and wife, other courts extend the concept of a "communication" to any information which one spouse may derive from or about the other by observation or otherwise, and which would not have been obtained except for the existence of the martial relation. McCormick, op. cit., § 83. While the privilege is primarily against the admission of the testimony of a spouse in court as to a confidential communication, there is substantial authority, which the Court accepts, that the privilege bars the disclosure of a confidential communication by proof of an extra-judicial statement of a spouse, which would otherwise be admissible in evidence. 8 Wigmore On Evidence, §§ 2232-2233; Olender v. United

States, 9 Cir., 219 F. 2d 795; United States v. Winfree, E.D. Pa., 170 F. Supp. 659.

However, the privilege is limited to communications which are confidential, and in some circumstances a particular communication is not deemed confidential although in other circumstances it might be. Of course, a communication which is disclosed with the consent of the spouse making the communication is not confidential after the disclosure. McCormick says in this connection (op. cit., § 84, pp. 172-173):

> "* * * Communications in private between husband and wife are assumed to be confidential unless the subject of the message or the circumstances show to the contrary. It is confidential if it was expressly made so, or if the subject is such that the communicating spouse would probably desire that the matter be kept secret, either because its disclosure would be embarrassing or for some other reason. * * * The fact that the communication relates to business transactions tends to show that it was not intended as confidential. Examples are statements about business agreements between the spouses, or about business matters transacted by one spouse as agent for the other, or about property, or conveyances. Usually such statements relate to facts which are intended later to become publicly known. To cloak them with privilege when the transactions come into litigation would be productive of special inconvenience and injustice."

It is the view of Wigmore that the privilege does not apply in the following situations, among others: If the spouse to whom the communication is made is acting as agent of the other spouse or has a joint property interest, and while agent or interested has made statements or done acts creating a liability on the part of the other in contract or in tort, those statements and acts are receivable

against the other, as against any other principal or owner, as his or her own vicarious admissions; if the statements are made by the spouse in the presence of the other and he acquiesces in their truth, the statements are admissible; if the wife's declarations relating to ownership of property are offered not as a wife's admissions, but as the declarations of a grantor or possessor, they may in certain circumstances be received as such. 8 Wigmore, op. cit., pp. 229-230.

When the admissions and declarations of Mr. and Mrs. Fowler admitted in evidence in this case are considered in the light of the principles which have been stated, the Court is convinced that they do not fall within the privilege, and that their admission in evidence was proper. The admissions and declarations relied on by the Government related solely to matters of business and property; they did not touch upon the personal lives of the Fowlers or upon the inter-spousal relationship between them. The evidence disclosed that Mr. and Mrs. Fowler ran their business affairs jointly, and that each in a sense was the agent of the other. The admissions consist, at least principally, of information which defendants turned over to their accountant for the purpose of enabling him to prepare their tax returns and of certain financial statements prepared on behalf of the defendants and purporting to list and value their assets and liabilities. When the information in question was disclosed to the accountant for the purposes mentioned and when it was incorporated in the tax returns and financial statements it lost any privilege which it might have had originally.

This brings up defendants' second contention in connection with their motion for a new trial, namely that it was error to admit evidence based upon or consisting of the work papers, documents, records, and testimony of Howard Pratt, C.P.A., the defendants' accountant and "confidential advisor." It is sufficient to dispose of this

contention to say that at the present time at least such materials and testimony are not privileged in the federal courts in tax cases. See Bouscher v. United States, 8 Cir., 316 F. 2d 451, 456; Sale v. United States, 8 Cir., 228 F. 2d 682, 686; Himmelfarb v. United States, 9 Cir., 175 F. 2d 924; In re Colton, S.D., N.Y., 201 F. Supp. 13, aff'd 2 Cir., 306 F. 2d 633; In re Fahey, W.D., Ky., 192 F. Supp. 492, aff'd 6 Cir., 300 F. 2d 383. This case does not involve the situation presented in United States v. Kovel, 2 Cir., 296 F. 2d 918, cited by defendants.

It is next contended that the Court erred in denying "defendants the privilege of projecting the effect on the depreciation reserve, listed as a liability in the net worth computation, of correction of useful life while still utilizing the straight-line method of depreciation accounting." This assignment of error is amplified in defendants' brief so as to charge the Court with certain prejudicial statements in the course of the trial and with error in instructing the jury. It is said that the Court chastised the defendants' expert witness Morris and destroyed his usefulness as a witness; that the "ruckus" accompanying Mr. Morris's attempt to reanalyze depreciation, as contrasted to the alleged "quiet acquiescence" of the Court in the Government's introduction of its own figures, gave the impression that the Government's figures were correct, and that the defendants were "up to some kind of chicanery" in their contention relating to depreciation, and that this impression was "highlighted by the admonition in (the Court's) charge that the taxpayers were stuck with the method adopted in their returns." This contention and the assertions of counsel need to be put into proper perspective.

The evidence disclosed that the method of depreciation selected by the defendants, or more properly by their original accountant, Mr. Pratt, was the straight line method. Mr. Pratt set up depreciation on certain property acquired

by the defendants prior to and during the indictment period on the basis of useful life periods determined by him.

After the defendants were indicted and employed counsel, Mr. Raymond Morris was engaged either by the defendants or by counsel as an expert accountant to assist in the defense and to testify as an expert witness. Mr. Morris made various and sundry studies and determinations relative to the net worth and income of the taxpayers. The results of his studies and his determinations were expressed on a summary exhibit which he had in his possession when he took the stand to testify for the defense.

One of the determinations of Morris was that on account of alleged obsolescence and other factors defendants' property should have been depreciated more rapidly, and that appropriate adjustments should be made, the effect of which would be to increase the reserves for depreciation during the indictment years, and thus reduce the defendants' net worth during those years.

When Morris's testimony reached that point, counsel for the Government objected on the ground that it was incompetent in this proceeding for the defendants to show that they could have taken lawfully more depreciation than they claimed when they filed their returns, and on the further ground that there was no competent evidence of record tending to show that the useful life of the property in question was in fact less than the period set up originally, and that there was a lack of competent evidence to show that certain items of property which Mr. Morris was proposing to depreciate were in fact subject to depreciation.

The Government's objection having been made, the Court and counsel retired to chambers and a rather lengthy conference was held outside the presence of the jury. In the course of that conference the Court examined Morris's proposed exhibit, which had not been offered in evidence at that point, and discovered that Morris in making his

adjustments with respect to depreciation had taken depreciation allowances which, under his theory, should have been claimed in years prior to the first indictment year, 1957, and claimed them for that year in addition to making the adjustments in depreciation allocable to 1957 itself. The effect of this approach was to completely wipe out any increase in net worth for 1957 and consequently any underreporting of income for that year. Indeed, under Morris's calculations the defendants had in fact over-reported their income for 1957.

The Court advised counsel that adjustments of depreciation would be permitted for the indictment years provided that a proper evidentiary foundation was laid, but that in the Court's estimation it was not proper for Mr. Morris to deduct with respect to 1957 depreciation which could or should have been claimed for prior years.

Court and counsel then returned to the courtroom and the trial resumed in the jury's presence. After asking Morris a few more questions counsel for the defendant passed him for cross examination and never offered his summary exhibit in evidence.

With regard to the propriety of the Court's ruling with respect to the manner in which Morris handled the adjustments in depreciation, it is argued that this manner was proper from an accounting standpoint. Assuming that to be true in certain situations, the Court does not feel it to be true in present context. The Court sees no justification for permitting a taxpayer in the trial of criminal charges against him to claim for a particular indictment year depreciation which should have been claimed with respect to prior years so as to create the specious impression that his income was not actually understated with respect to the year for which the additional depreciation is claimed ex post facto.

As to counsel's assertions with respect to the Court's conduct in relation to the testimony of Morris, the Court

never "chastised" Mr. Morris or criticized or belittled his exhibit, which, as stated, was never offered in evidence, and there was certainly no "ruckus" about Mr. Morris or his testimony. It is true that Mr. Morris, who is a lawyer as well as an accountant, manifested at times a tendency to volunteer information and to become somewhat oratorical, and at one point the Government objected to some of Morris's statements. The Government's objection was sustained, and Mr. Morris was admonished, the Court thinks properly, to confine himself to answering the questions propounded to him.

As far as the Court's charge to the jury relative to depreciation is concerned, the Court sees nothing in the pertinent portion of the charge which could have prejudiced the defendants, and they did not object to that portion of the charge. They did request an instruction dealing with obsolescence, and the Court gave that requested instruction in practically the identical language in which it was couched by counsel for the defendants.

Before leaving the question of depreciation, it should be said that contemporaneously with the filing of the motion now under consideration, defendants filed an affidavit from Mr. Morris, to which was attached an amended net worth computation covering the indictment years. That computation makes certain corrections in the Government's net worth figures at the beginning and end of each indictment year and corrections in the Government's reconstruction of tax liability and deficiency. The corrections are in a number of areas, including depreciation.

In the Court's opinion this affidavit and computation have no place in this case at this stage. The defendants failed to put Mr. Morris's original exhibit or any part of it into the record during the trial, and they are not entitled to supply deficiencies in the record in connection with a motion for a new trial; nor do they have a right to have Mr. Morris testify post-trial by means of an affidavit.

Passing on to defendants' next contention, complaint is made that the Court refused to instruct the jury that the Government's failure to introduce evidence of analyses of defendants' bank accounts justified the inference that such evidence had it been introduced would have been unfavorable to the Government's case.

Prior to the trial the defendants filed a motion for a bill of particulars. At a hearing held on the motion counsel for the Government stated that this was "a net worth plus non-deductible expenditures case, supplemented by bank account analyses." In a formal response filed by the Government pursuant to an order entered by the Court following the hearing just mentioned it was stated that there were certain identified bank accounts upon which an analysis "may be predicated." The matter of bank account analysis was not, as the Court recalls, mentioned in the course of the trial.

The Court does not understand that the Government purported to bind itself to introduce evidence of analyses of defendants' bank accounts, nor do the defendants contend that they have been actually prejudiced by the Government's failure to do so. The Court does not know why the Government did not introduce such evidence, or what that eviednce would have revealed, or why the defendants did not introduce evidence of their own as to the cash flow through their accounts and as to the nature of deposits and withdrawals. There was evidence that the defendants as an accommodation for their customers and to promote good will provided a check cashing service which, of course, involved substantial cash deposits and withdrawals by defendants, which deposits and withdrawals would not evidence business receipts or disbursements. It is quite possible that deposits and withdrawals of the nature just mentioned prevented any intelligent analysis of defendants' bank accounts from which inferences of income or the lack thereof might be drawn.

In any event the Court feels that the request was properly refused. While there are cases holding that such an instruction is proper, United States v. Grannis, 4 Cir., 172 F. 2d 507; Plunkett v. Levengston, 7 Cir., 258 Fed. 889; Carmody v. Capital Traction Co., C.A. D.C., 43 App. D.C. 245, Ann. Cas. 1916D 706; Young v. Corrigan, D.C. Ohio, 208 Fed. 431, it has been held that the better rule is that whether an instruction as to the effect to be given to the failure of a party to produce available evidence which would be introduced normally if it was favorable to such party should be given is a matter within the trial court's discretion.

In no event would the Court have given the requested instruction in a vacuum. It would have been necessary for the Court to instruct in some detail as to the bank account analysis method of proof, the assumptions on which it is based, its circumstantial nature, and the degree of correlation to be reasonably expected between a net worth reconstruction of income and a reconstruction based upon an analysis of a bank account or of bank accounts. To have gone into those matters in a case in which no bank account analysis evidence had been introduced would simply have been confusing to the jury which had enough to do to comprehend the net worth testimony which it had heard without speculating on the fact that it had not heard evidence of some other type.

It is next asserted that questions, observations, and comments of the Court destroyed the Court's position of impartiality in the eyes of the jury. In his brief counsel for the defendants elaborates on that assertion in the motion by making complaints about comments of the Court in connection with the cross examination of the witness Tyler, further complaints about the Court's statements and attitude with regard to Mr. Morris, and a complaint as to a remark made by the Court when counsel indicated a desire to poll the jury after that body had returned its verdicts.

As far as Mr. Morris is concerned, the Court has already commented to some extent about what transpired in the course of the testimony of that witness. The Court will add at this point that it is not conscious of having done anything or said anything which would reflect on Mr. Morris or on his credibility as a witness or which would demean him as a witness in the eyes of the jury. As indicated, the Court did instruct Morris to answer the questions put to him. In the trial of a criminal case, and particularly in the trial of long cases such as this one, the Court not only has the right but also the duty to keep the testimony within reasonable bounds and not to permit a witness to digress.

Late in the morning of the third day of the trial the Government called to the stand a Mr. Tyler, vice president and manager of the North Little Rock Savings & Loan Association from which organization the defendants had on occasions borrowed money. The witness was called to identify and testify about certain loans and with respect to a financial statement of the defendants prepared in connection with a loan application made in January 1959. According to the testimony of Tyler, the application was taken by Howard Johnson, an employee of the Association; part of the information in the application seems to have been supplied by Mr. Johnson; other information was obviously furnished by the Fowlers. The Fowlers signed the application and it was notarized, a point upon which counsel for the Government laid some emphasis.

In the course of the cross, redirect, and recross examination of Mr. Tyler a good deal of time was devoted to the significance of the notarization, the accuracy of the information set forth in the financial statement, the extent to which the statement was intended to be relied upon in connection with the loan application, and the alleged tendency of borrows to make "puffing" statements about their assets when applying for loans. The interrogation of the witness along those lines reached a point where it appeared to the Court that the results being obtained were not worth

the time being consumed. The Court so advised counsel and terminated that line of testimony. The Court told the jury, however, in unmistakable terms that while the Court did not think that the testimony in question was of great importance, it was for the jury to say what the testimony was worth and what weight, if any, was to be given to it, and that the jury was not in any sense bound by the Court's opinion about the matter. The Court cannot agree with counsel for the defendants that the action of the Court destroyed the effectiveness of the cross examination of Tyler, or that defendants were prejudiced by the Court's actions or statements. Indeed it may be noted in this connection that while the financial statement under discussion was introduced in evidence, the figures thereon were not read to the jury, the document itself was never shown to the jury, and neither the statement nor its contents were ever referred to again in the course of the trial.

When the jury sent word to the Court that it had agreed upon its verdicts, the Marshal was directed to bring the jury into open court which was done. The Court inquired whether the jury had agreed upon its verdicts, and the foreman replied that agreement had been reached. The verdicts were then handed to the Marshal who in turn handed them to the Clerk, and they were read in open court. The Court inquired of the jury generally whether the verdicts returned were those in fact agreed upon, and the entire jury manifested in one way or another that they were. The Court then announced that the verdicts would be accepted and filed and started to make certain remarks to the jury when counsel interrupted the Court with a request that the jury be polled. The Court granted that request but manifested some annoyance at the interruption. The jury was then polled and each individual juror announced without any hesitation whatever that the verdicts returned and read in open court were his verdicts. The Court then concluded the trial by saying that it agreed with the jury in the verdicts returned by it.

Defendants now complain that the Court's manifestation of annoyance which has been mentioned prejudiced the jury and rendered the poll ineffective. That complaint is wholly without merit.

The jury which heard this case was an intelligent jury; it returned its verdicts after due deliberation; the verdicts were clearly and distinctly read and intently listened to by the jury; as stated, the Court before accepting the verdicts inquired whether the verdicts returned reflected the findings of the jury, and did not accept the verdicts until it was satisfied by the words or acts of the individual jurors that each juror concurred in the verdicts. Had the Court observed manifestation of reluctance or dissent on the part of any juror or jurors, the verdicts would not have been received without further inquiry and would not have been accepted if the Court had entertained any doubt that they represented the actual and voluntary conclusion of each individual juror.

As counsel for the defendant knows, or should know from his experience at the Bar, polls of juries in the courts of Arkansas, including Arkansas federal courts, are extremely rare. In fact, this is the first time that there has been a request for a jury poll made to the judge who presided in this case, and the Court did not know for what purpose counsel rose when he interrupted the Court. Conceding, as the Court does, that the Court should not have manifested annoyance at the interruption, and that was all that the Court did, the Court does not believe that the manifestation prejudiced the jury or had any effect whatever on the poll.

Finally, defendants complain of the closing arguments of counsel for the Government. One of those arguments was made by Chief Assistant United States Attorney Gallman, and the other by Assistant United States Attorney Davis. Defendants made no objection to the argument of Mr. Gallman while it was in progress. Objection was made to

a certain portion of the argument of Mr. Davis. The objection was overruled. The Court paid close attention to all of the arguments made at the conclusion of the testimony, and did not and does not consider that any of them were improper in the circumstances and under the evidence. At the conclusion of the arguments the jury was instructed in detail as to the law of the case, and it was made clear to the jury that the case was to be decided on the law and the evidence. This final contention of the defendants, like their others, is rejected.

An order has been entered denying defendants' motion in its entirety.

Dated this 12th day of November, 1964.

/s/ J. Smith Henley
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 17,881.

John S. Fowler, et al., *Appellants,*

v.

United States of America, *Appellee.*

Appeal from the United States District Court
for the Eastern District of Arkansas.

[November 4, 1965.]

Before Vogel, Matthes and Ridge, Circuit Judges.

Vogel, Circuit Judge.

John S. Fowler and his wife, Jimmie Lea Fowler, appellants herein, were indicted and convicted in a jury trial on three separate counts for evasion of federal income taxes for the years 1957, 1958 and 1959 in contravention

of 26 U.S.C.A. § 7201.[1] On the three counts John S. Fowler was fined $2,000 and sentenced to 90 days' imprisonment. Additional sentence was suspended but Fowler was ordered placed on probation for a two-year period beginning with his release from prison. Jimmie Lea Fowler was fined $2,000 and placed on probation for a two-year period. Appellants perfect this appeal from the judgments of conviction.

Appellants were indicted for knowingly and willfully filing false and fraudulent income tax returns, with intent to evade and defeat substantial portions of their income tax liability for the years 1957, 1958 and 1959, by substantially understating their true taxable income and income taxes due thereon. Appellants were charged in the indictment with stating their 1957 taxable income as being $820.90 and their 1957 tax due and owing as being $164.18, whereas the figures should have been $10,747.99 and $2,677.98, respectively. For 1958 appellants reported a taxable income of $147.18 and a tax due and owing of $29.44, whereas these figures allegedly should have been $19,399.27 and $5,359.25, respectively. For 1959, it was charged that appellants had taxable income of $43,056.80 and a tax due and owing of $16,523.40, whereas they reported only $3,973.18 and $943.52, respectively.

Prior to and during the indictment period appellants resided in North Little Rock, Arkansas, and derived income from the Broadway Motel and Restaurant and from other small hotels and motels owned by them. Appellants also earned income from other rental property and

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[1] Under this section:

"Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisioned not more than 5 years, or both, together with the costs of prosecution."

sources in or near Little Rock and North Little Rock, Arkansas. Dorothy Calva, a daughter-in-law of appellants, and appellant Jimmie Lea Fowler maintained two sets of books, one applying to the Broadway Motel and Restaurant, and the other, with appropriate divisions, applying to the remaining hotels and rental properties. Neither Dorothy Calva nor Mrs. Fowler had any formal training as bookkeepers. The books apparently can best be described as being a single entry system with columnar headings. Receipts were recorded and general business expenses were classified in the books.

The government proceeded under the net worth plus non-deductible expenditures method of proof for showing income tax evasion. The net worth method of proof is described in *Holland* v. *United States*, 1954, 348 U.S. 121, 125, as follows:

> "In a typical net worth prosecution, the Government, having concluded that the taxpayer's records are inadequate as a basis for determining income tax liability, attempts to establish an 'opening net worth' or total net value of the taxpayer's assets at the beginning of a given year. It then proves increases in the taxpayer's net worth for each succeeding year during the period under examination and calculates the difference between the adjusted net values of the taxpayer's assets at the beginning and end of each of the years involved. The taxpayer's non-deductible expenditures, including living expenses, are added to these increases, and if the resulting figure for any year is substantially greater than the taxable income reported by the taxpayer for that year, the Government claims the excess represents unreported taxable income. * * *"

In the instant case net worth was determined as of January 1, 1957, December 31, 1957, December 31, 1958, and

December 31, 1959. Net worth for prior years was also determined to further substantiate the figure of January 1, 1957. Further facts will be set out as needed.

I.

Appellants contend there was non-compliance with the edict in *Holland* v. *United States,* supra, that the concept of the net worth approximation of income " * * * is so fraught with danger for the innocent that the courts must closely scrutinize its use." 348 U.S. 125. Appellants feel that the government did not correctly apply, and that the trial court did not correctly interpret, the net worth method as a matter of law. More specifically, appellants allege, in substance, the following enumerated errors:

1. Appellants contend that the government agents erred in that they admitted their net worth computation did not consider accounts receivable as an asset nor accounts payable as a liability in determining net worth as of January 1, 1957. There was no error here. Appellants admit that they were on a cash basis for purposes of paying income taxes. The government was bound to follow appellants' method of accounting in computing taxable income. *Morrison* v. *United States,* 4 Cir., 1959, 270 F.2d 1, certiorari denied, 361 U.S. 894, 80 S.Ct. 196, 4 L.Ed.2d 150. Under a cash basis method, accounts receivable and payable are not included as part of net worth. As stated in *United States* v. *Vardine,* 2 Cir., 1962, 305 F.2d 60, 64:

> " * * * If a taxpayer disregards his accounts payable in reporting income on his annual tax return, i.e., reports as a cash basis taxpayer, then the government in computing his net worth in order to check the income reported on his tax return must also disregard these amounts."

2. In arriving at what were non-deductible personal expenses as opposed to what were deductible business expenses (the former being added to net worth), appellants

contend that the investigating agent for the government made his decision simply by examining the faces of the checks reflecting the expenditures. The facts do not bear appellants out on this point. The appellants themselves identified most of a list of 535 checks submitted to them for identification during the investigation. Many of the checks used to pay for personal expenses had a notation in the form of the word "personal" written on them. It appears that the government's characterization of the checks was primarily based on the appellant's own characterization of the nature of the expenditure and on the obvious nature of the items purchased with the checks (such as clothing from a department store). The government had the burden of persuasion to establish characterization of the checks in proving net worth. *Mighell* v. *United States,* 10 Cir., 1956, 233 F.2d 731, certiorari denied, 352 U.S. 832, 77 S.Ct. 47, 1 L.Ed.2d 52. Here the government met this burden in light of the evidence discussed. The jury could reasonably have agreed with the government's classification.

3. By way of illustration, appellants make the following accusation against the trial judge, who they allege was hindering appellants' attack against the use of the net worth method:

> " • • • Disregarding the clear mandate of and caution expressed by the Supreme Court in *Holland,* the trial Court cut off an attempt by the expert of the taxpayers [Mr. Raymond R. Morris] to demonstrate one pitfall to accuracy of the net worth statement—the absence of the check and balance available in any double entry system of accounting. This next related exchange made crystal clear to the jury that the trial Court thought well of the net worth technique and would brook no attack upon it: (R. 746-747)
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> "The Court: Now wait a minute. You say there are no checks or balances on the accuracy of a balance sheet or net worth computation?

"Mr. Bowen [appellants' counsel]: No, contrasted, your Honor, with a double entry system of bookkeeping.

"The Court: An accountant or no, there are some checks on any system. You at least can add it up twice. Let's not go that far, gentlemen. Go ahead and qualify your statement; I'm afraid I don't understand all the qualifications.

"Here the Court not only challenged any attack upon the accuracy of the technique, it equated the net worth computation with a balance sheet which is broadly and widely accepted in business and commerce."

Appellants failed to quote what took place immediately prior to this:

"Q. Mr. Morris, the practice to this [single entry bookkeeping] system [used by appellants] says it is approved by tax authorities and auditors and recommended by leading accountants; is this single entry system a type that you would recommend or install?

"A. No, sir, I wouldn't. Now, I might add that probably that refers to the book itself, that so far as the columns are concerned and the income and expense allocation, it can be converted into a double entry system; but the breakdown and maintenance of those books, if the information is put on correctly, would reflect the income. Now, I might add this, that the only difference between a double entry set of books and a single entry is a determination of mathematical accuracy of those books. *If a single entry and everything put down correctly it will reflect the correct result; but it's just like adding two columns of figures, put the same figures down twice and add them twice. It's for the purpose of seeing your totals are right in the first place; so if you put down everything in the credit and everything in the debit and add them up*

together you know they will come out. That is the mechanical accuracy and not the accuracy of the figures themselves.

"Q. So this single entry system that was here used is an accurate system if all the details are correct, but there is no way to check because you don't have the double entry.

"A. No way to check the mechanical accuracy.

"Q. How would you characterize the net worth estimate of income; is it a single or double entry approach to analyzing income?

"A. Actually, single entry if they substitute for determining, attempting to determine the amount of income that may be realized by a particular taxpayer over a period of time.

"Q. So that there are no checks and balances then on the accuracy of a net worth system either, are they?

"A. I think it—" (Emphasis supplied.)

The trial court, far from intruding into appellants' attack on the net worth system, was attempting only to clarify and to amplify what Mr. Morris had himself previously brought out. The jury in this case, as is clearly evidenced in the nearly 1,000-page record, was given much in the way of detailed analysis throughout this case. It would only be natural for the judge to attempt to pin down what the witness himself had already alluded to. Appellants' counsel apparently recognized this for he stated in the record at a point immediately following the portion of the record objected to by appellants:

> "Let's review then this area, because I think the Court's interest makes it important to us and the jury that we understand it."

Thereupon Mr. Morris was permitted, without further "intrusion" by the court, to make his position clear to the jury.

As to other contentions by the appellants that Mr. Morris was unfairly rebuked in not being able to set out all of his opinions and to explain all of his statements, we note that the record contains many instances where Mr. Morris was not responsive and where he tended to give very long and sometimes irrelevant answers. The record fully supports Judge Henley's assertion in his Memorandum Opinion that:

> "As far as Mr. Morris is concerned, the Court has already commented to some extent about what transpired in the course of the testimony of that witness. The Court will add at this point that it is not conscious of having done anything or said anything which would reflect on Mr. Morris or on his credibility as a witness or which would demean him as a witness in the eyes of the jury. As indicated, the Court did instruct Morris to answer the questions put to him. In the trial of a criminal case, and particularly in the trial of long cases such as this one, the Court not only has the right but also the duty to keep the testimony within reasonable bounds and not to permit a witness to digress."

Read as a whole, the record clearly indicates that the court was concerned only with clarifying the issues and with aiding the jury's understanding. Witnesses for both sides were treated equally insofar as the judge was attempting to provide for an effective presentation of the issues involved.

4. In an effort to overcome that part of the "bulge" shown between appellants' opening and closing net worth on which taxes were not paid, appellants allege there should be taken into consideration a previously unreported depreciation deduction to take care of increased obsolescence of certain properties of appellants which took place during the years in controversy. Appellants' accountant, Mr.

Howard Pratt, who made out appellant's tax returns, had used a conservative straight-line method of depreciating capital assets owned by appellants. Appellants alleged that such straight-line depreciation did not fairly cover the obsolescence of certain properties of appellants, which obsolescence was caused by the building of interstate highways in the area. Although plans for the highways were disclosed by the newspapers as early as March 21, 1956, no parts of the highways were completed until the 1960's. It is appellants' contention that with these new highways being planned during the indictment years, the straight-line method did not adequately take into account the fact that appellants' overnight lodging properties would become obsolete at a faster rate than originaly anticipated (since the properties abutted former main thoroughfares), and that this obsolescence could be deducted as a matter of law at trial to aid in defeating the net worth bulge.

The following instruction, requested by appellants, was given to the jury:

> "Some evidence has been introduced relative to alleged obsolescence. You are instructed in connection with obsolescence that if facts upon which a conclusion of obsolescence may be based are known during or prior to the year or years in issue, this factor may be utilized by the defendants although not incorporated in their tax returns."

Appellants were entitled to no more than this instruction for there was not obsolescence as a matter of law. As stated by the Supreme Court in *Real Estate-Land Title & Trust Co.* v. *United States,* 1940, 309 U.S. 13, 17:

> " • • • For obsolescence under the [Internal Revenue] Act requires that the operative cause of the present or growing uselessness arise from external forces which make it desirable or imperative that the property be replaced. What those operative causes may be

will be dependent on a wide variety of *factual* situations. * * * " (Emphasis supplied.)

Cf., *Keller Street Development Co.* v. *Commissioner of Internal Revenue,* 9 Cir., 1963, 323 F.2d 166. There was evidence in the record, obviously believed by the jury, that there should not have been increases in deductions for obsolescence for the years in controversy. An example of such evidence is that in 1959 appellants were able to obtain a $100,000 loan from a savings and loan institution, indicating that the so-called "obsolete" property certainly did have certain security value. The extent of the value and the amount of obsolescence, as viewed from the indictment years, was, then, clearly a jury question. As stated in Mertens Law of Federal Income Taxation, Vol. 4, § 23.102, at pp. 210-211 (Rev. Ed. 1960):

> " * * * The purpose of allowing a deduction for obsolescence is to permit the taxpayer a return of his capital out of earnings over the economic useful life of the property notwithstanding its possibly longer physical life or ordinarily useful life. The foundation for obsolescence is the expected early abandonment of the property, which for this purpose means the scrapping of the property and not the sale, at a time when it had substantial value and was to be used for other purposes. *The deduction for obsolescence is, accordingly, not properly allowable in the absence of a showing that* (1) *there are substantial reasons for the belief that the property would become obsolete prior to the end of its ordinary useful life,* and (2) there is a reasonable degree of certainty, under all the available facts and circumstances, as to when that event would probably occur." (Emphasis supplied.)

It is interesting to note, also, that a summary showing the extent of obsolescence, prepared by witness Morris, was not presented at trial but, rather, appellants attempted to

present Mr. Morris' summary through an affidavit filed with the motion for judgment of acquittal or a new trial. There is no reason given by appellants as to why Mr. Morris' summary could not have been presented before the jury at trial.

5. Relating to depreciation other than obsolescence, the appellants charged that the trial court erred in not allowing witness Morris, except for purposes of showing appellants' intent, to testify as to how appellants could have taken greater depreciation (through recomputing the useful life of certain assets) during the years in controversy so as to reduce the net worth bulge for those years. Appellants cite § 1.167(a)-1(b) of the Treasury Regulations in support of their proposition. That regulation provides:

> "* * * The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable years and *shall be redetermined when necessary regardless of the method of computing depreciation.*" (Emphasis supplied by appellants.)

Without dealing with the validity of this regulation, it is only necessary to point out that in the years involved appellants did not elect to recompute the estimated remaining useful life of the assets involved. Nobody is contending that they could not have done so at that time. Appellants evaded their taxes years ago and they cannot, some eight to ten years later, now attempt to justify their evasion by recomputing the useful life of certain then-existing assets. Appellants at that time elected one method of determining depreciation and that election binds them for purposes of this action.

6. Appellants contend that their net worth for 1959 should be decreased by $1,700, the amount paid out for attorney's fees for, and in settlement of, a suit brought by a waitress at the Broadway Restaurant against appellant

John S. Fowler. This expense was treated by the government as a non-deductible personal expenditure, even though appellants showed it on their returns as a legal expense. Through testimony of appellants' own witness it was established that the incident arose at a time when the Broadway Restaurant was being leased by the Fowlers to Ann Harris. On November 8, 1958, Mrs. Harris phoned Mr. Fowler and told him that the waitress involved was drunk on the job. At the request of Mrs. Harris, the lessee, Mr. Fowler "escorted" the waitress out of the back door of the cafe. The waitress sued Mr. Fowler for $80,000, and, after a mistrial, the settlement was reached. The court allowed testimony on this incident although, because of appellants' objection, the waitress herself was not allowed to testify since possible prejudicial effects might have arisen. Appellants' witness Dorothy Calva did testify as to the incident however. It was for the jury to determine whether or not this expense was personal or business since, as a matter of law, there was no uncontroverted showing that this incident arose out of Mr. Fowler's business as opposed to being a non-deductible personal tort. *Pantages Theatre Co.* v. *Welch,* 9 Cir., 1934, 71 F.2d 68. If anything, the incident more likely arose out of Mrs. Harris' business.

7. In determining appellants' opening net worth, the government assigned a value of $2,000 to cash on hand based on certain admissions made by the appellants at the time the investigation against them commenced. Corroboration is required of admissions made after the fact of the crime in controversy, where such admissions embrace an element vital to the government's case. *Smith* v. *United States,* 1954, 348 U.S. 147, 155, 75 S.Ct. 194, 99 L. Ed. 192; *Smith* v. *United States,* 8 Cir., 1956, 236 F.2d 260, 265, certiorari denied, 352 U.S. 909, 77 S.Ct. 148, 1 L.Ed. 2d 118, rehearing denied, 353 U.S. 989, 77 S.Ct. 1280, 1 L. Ed.2d 1147. Sufficient corroborative evidence was present in the instant case to support the admissions made by appellants concerning their cash on hand. Cash on hand was

used by appellants primarily to meet the demands of a check-cashing service and the largest exchange of checks for cash for any one day was well within the $2,000 claimed. The reasonableness and accuracy of the $2,000 figure was further confirmed through the analysis of appellants' bank accounts, the analysis of a 1955 Small Business Administration loan application filed by appellants, and the analysis of a 1959 loan application filed by the appellants at a savings and loan association. The Small Business loan application was filed before the crimes in controversy occurred and thus the admissions made by appellants on such application need not be corroborated. *Warszower* v. *United States,* 1941, 312 U.S. 342, 347, 61 S.Ct. 603, 606, 85 L.Ed. 876. As stated in the recent case of *United States* v. *Mackey,* 7 Cir., 1965, 345 F.2d 499, 506:

> "Whether defendant had substantial sums of cash at the starting point is a matter within defendant's knowledge. Under circumstances such as those in this case, where Government conducted a thorough investigation and failed to uncover evidence of cash on hand, the burden is on defendant to come forward with evidence of cash and he remains quiet at his peril. See *Holland* v. *United States,* 348 U.S. 121, 138-139, 75 S.Ct. 127, 99 L.Ed. 150 (1954) and *United States* v. *Holovachka,* 7 Cir., 314 F.2d 345, 354 (1963)."

In the instant case the government conducted such a thorough investigation. Appellants failed to come up with any affirmative off-setting evidence. This was ultimately a question for the jury. *United States* v. *Ford,* 2 Cir., 1956, 237 F.2d 57, 63, reversed on other grounds, 355 U.S. 38, 78 S.Ct. 114, 2 L.Ed.2d 71.

8. Finally, appellants argue that there is error in the net worth analysis in that it fails to take into account, so as to reduce the net worth bulge, the so-called check

float—i.e., checks that were written in one year and which did not clear until the next year. The appellants further argue that money allegedly left with the Fowlers by one Bill Landers in trust was not properly treated in computing net worth for 1958 and 1959. Other significant errors, according to appellants, concern the treatment of an installment loan taken by appellants in 1958 and the omission of certain automobiles in computing the Fowlers' assets and expenditures.

Except possibly as relating to the check float, we believe that it was a jury question as to the points raised by appellants. From the evidence the jury could have reasonably believed that the government acted correctly in dealing with the above-stated matters. Perhaps under the authority of *United States* v. *Vardine,* supra, the check float as a matter of law should be utilized to reduce the unexplained net worth bulge.[2] It should be noted that in the instant case there was no evidence of when the checks were delivered to the payees or no evidence to show whether or not the checks went to reduce existing liabilities (which would off-set, to the extent of any liability decrease, any error for not including check float as a reduction of assets).

Even assuming that appellants are correct in all matters relating to the trust fund, the loan, the automobiles and the check float, there was no prejudicial error here.

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[2] In *Vardine,* the court stated, at page 65 of 305 F. 2d:

"* * * The trial judge left it up to the jury whether to deduct these outstanding checks from the defendant's year-end checking account balance, and the government, on their net worth summary, showed the balance as it stood on the bank's books. This was error. When a cash basis taxpayer delivers his check without any limitation on the payee's ability to cash it immediately, the taxpayer is entitled to a deduction at the time of delivery. *Clark* v. *Commissioner,* 253 F. 2d 745 (3 Cir. 1958)."

As the computation in footnote [3] shows, there was still substantial evidence of tax evasion even if we accept appellants' contentions in these areas.

In summary, then, we feel there was no substantial prejudicial error present so as to support the claim of appellants that the net worth computation in this case was not properly prepared by the government or properly

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[3] This computation combines Government Exhibit No. 44 with pertinent aspects of the Morris computation attached to appellants' motion for acquittal and, in the alternative, for a new trial. For purposes of this computation we have accepted all of appellants' corrections as to the trust fund, the loan, the automobiles, and the check float. Even read as redone, the exhibit makes it clear that appellants substantially understated their taxable income for 1957, 1958 and 1959.

	Balance Jan. 1, 1957	Balance Dec. 31, 1957	Balance Dec. 31, 1958	Balance Dec. 31, 1959
Net worth per Exhibit #44*	$96,915.77	$106,410.72	$123,852.61	$165,370.56
Outstanding checks*	(1,064.10)	(4,255.70)	(3,527.00)	(4,615.41)
Bill Landers' "trust fund"*			1,450.00	
Oldsmobile*	2,243.71	2,243.71		
'58 Cadillac*			6,743.71	
'59 Cadillac*				6,245.68
Loan due bank*			(3,847.90)	(1,417.66)
Total net worth	98,095.38	104,398.73	124,671.42	165,583.17
Prior net worth		98,095.38	104,398.73	124,671.42
Increase in net worth		6,303.35	20,272.69	40,911.75
Adjusted personal expenditures**		3,037.10	3,786.00	10,572.70
Subtotal		9,340.45	24,058.69	51,484.45
Less non-taxable receipts per Exhibit #44*		(812.06)	(3,504.87)	(3,594.47)
Corrected net (taxable) income of appellants		8,528.39	20,553.82	47,889.98
Reported net income of appellants*		(2,466.15)	(1,496.87)	(5,747.98)
Understatement of income		6,062.24	19,056.95	42,142.00

* These are figures accepted and used by Morris in his computation.

** This uses as a basis Government Exhibit No. 44 and reflects payments on loan liability and adjustment for personal auto using the figures provided by Morris.

ruled on by the trial court. As stated by this court in *Smith* v. *United States,* supra, at page 264 of 236 F.2d:

> "* * * the government is not required to show the exact amount of error. If the understated taxable income be substantial, that is sufficient because the exact amount is not the gist of the offense. *Cave* v. *United States,* 8 Cir., 1947, 159 F.2d 464, 468."

Certainly, as is evidenced by the computation set out in f.n. 3, supra, there was a substantial understatement of taxable income by appellants herein. The government followed the guidelines set out in the *Holland* case, supra, at pages 135-136 of 348 U.S., where it is stated:

> "* * * When the Government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt. Such refutation might fail when the Government does not track down relevant leads furnished by the taxpayer—leads reasonably susceptible of being checked, which, if true, would establish the taxpayer's innocence."

In the instant case the bookkeeping system of appellants was inadequate and the government had little choice but to resort to proof of tax evasion through the introduction of circumstantial evidence. The record clearly points out, however, that the government did follow up on all substantial leads and thus protected the rights of appellants. The trial court correctly instructed on the net worth method of proof and there can be no claim of error here.

II.

As alluded to earlier in this opinion, appellants strongly urge that there was undue intrusion by the court in con-

ducting the trial. Also appellants contend that the government made improper references in its closing argument so as to deny them a fair trial. A perusal of the nearly 1,000-page record indicates that such allegations are without merit. One example of intrusion raised by appellants concerned the court's actions during the testimony of Raymond R. Morris. This matter has already been discussed and determined adversely to appellants. Other examples raised by appellants, when taken in context, are equally without merit. The duty of a federal judge in a criminal case has been described by this court in *Franano* v. *United States,* 8 Cir., 1962, 310 F.2d 533, 537, certiorari denied, 373 U.S. 940, 83 S.Ct. 1545, 10 L.Ed.2d 694, to be as follows:

> "There can be no doubt that a federal judge in a criminal case is more than a mere moderator and may assist the jury in arriving at a just conclusion by explaining and commenting upon the evidence and by expressing his opinion upon the facts, provided he clearly states to the jury that all matters of fact are submitted to their determination. *Quercia* v. *United States,* 289 U.S. 466, 469, 53 S.Ct. 698, 77 L.Ed. 1321 (1933); *Northcraft* v. *United States,* supra, 271 F.2d at 188-189; *Myres* v. *United States,* 8 Cir., 174 F.2d 329, 338 (1949), cert. denied, 338 U.S. 849, 70 S.Ct. 91, 94 L.Ed. 520 (1949); *Buchanan* v. *United States,* 8 Cir., 15 F.2d 496, 497-498 (1926). However, since a trial judge's influence upon a jury is necessarily of such great magnitude, a trial judge should exercise care and discretion in expressing an opinion so as not to mislead or, in effect, to destroy the jury's right as the sole arbiters of all fact questions. *Quercia* v. *United States,* supra, 289 U.S. at 470, 53 S.Ct. at 699; *Holmes* v. *United States,* 4 Cir., 271 F.2d 635, 639 (1959); *Stoneking* v. *United States,* 8 Cir., 232 F.2d 385, 389-390 (1956), cert. denied, 352 U.S. 835, 77 S.Ct. 54, 1 L.Ed.2d 54 (1956); *Cook* v. *United States,* 8 Cir., 18 F.2d 50, 52 (1927)."

See, also, *United States* v. *DeFillo*, 2 Cir., 1958, 257 F.2d 835, 839-840, certiorari denied, 359 U.S. 915, 79 S.Ct. 591, 3 L.Ed.2d 577. Clearly these duties were followed by Judge Henley in this case.

The reference made by the government in closing argument to which appellants object is as follows:

> "Well, I think now we can get to the point of what defense has left after we look at that. They have a long series of theories, obsolescence, depreciation, explanations, rationalizations, policies, excuses. Every crime committed can be explained away or excused. There's no question about that. But this case, then, becomes quite simple. Do you want to forgive these people or do you not want to forgive them? But why not? Everybody cheats a little bit on their income tax. The Government case, it's so complicated, I can't understand it, or how can we be sure they didn't make a mistake? So here's the answer to those questions. The law makes tax evasion a crime. We have proven tax evasion. Now, it's up to you to do, as you are sworn to do, a true deliverance and verdict make. You and each of you have got to look into your own conscience and ask: Am I going to stand on the side of good or am I going to stand on the side of evil. Today we hear much of moral decay. If such is happening it is because we each are failing in our responsibility. It would have been much easier for me to stay in that seat and sit there and be an observer, to stay on the sideline, but my conscience told me about three days ago that I couldn't sit idly by and not let you folks know how I feel about this case."

In view of all the testimony in this case, in view of the pertinent instructions provided by Judge Henley, and in view of the closing arguments as a whole, this argument was not so offensive or prejudicial as to prevent the jury from exercising freedom of judgment and thought in its

deliberations. *Isaacs* v. *United States,* 8 Cir., 1962, 301 F.2d 706, 738, certiorari denied, 371 U.S. 818, 83 S.Ct. 32, 9 L.Ed.2d 58.

III.

Appellants, neither of whom chose to testify, maintain that there was no showing in any event that they had or could have willfully evaded their income taxes for the years in question. As stated by the Supreme Court in the *Holland* case, supra, at page 139 of 348 U.S.:

> "A final element necessary for conviction is willfulness. The petitioners contend that willfulness 'involves a specific intent which must be proven by independent evidence and which cannot be inferred from the mere understatement of income.' This is a fair statement of the rule. Here, however, there was evidence of a consistent pattern of underreporting large amounts of income, and of the failure on petitioners' part to include all of their income in their books and records. Since, on proper submission, the jury could have found that these acts supported an inference of willfulness, their verdict must stand. *Spies* v. *United States, supra,* [317 U.S. 492] at 499-500."

Accord: *Smith* v. *United States,* 1954, 348 U.S. 147, 157, 75 S.Ct. 194, 99 L.Ed. 192. Willfulness and fraudulent purpose are questions for the jury. *United States* v. *Vardine,* supra, at 63; *United States* v. *Schenck,* 2 Cir., 1942, 126 F.2d 702, 707, certiorari denied, sub. nom. *Moskowitz* v. *United States,* 1942, 316 U.S. 705, 62 S.Ct. 1309, 86 L.Ed. 1773.

Certainly there was sufficient evidence presented here to submit the question of willfulness to the jury. The government, although only prosecuting appellants for the years 1957 through 1959, presented evidence of the financial condition of appellants from 1954 through 1959. It was shown that appellants had a pattern of failing to report large amounts of income and that large sums of

income were not recorded in their books and records. Appellants apparently did not inform their tax return preparer, Mr. Pratt, of all of their income. The evidence showed appellants maintained a high standard of living throughout the indictment period. There was substantial evidence for a jury to find the requisite intent and willfulness to uphold the conviction herein.

Much is made of the fact that appellants John S. Fowler and Jimmie Lea Fowler had only a third- and eighth-grade education respectively. The gist of this assertion, apparently, is that appellants were thus not capable of forming the requisite intent to evade taxes. This is obviously fallacious reasoning. Appellants were apparently intelligent enough to operate a series of successful businesses and did very well at it. This being so, they could certainly plan to evade tax obligations. One's capacity is measurable by more than just his formal education. Furthermore, the government correctly points out the following in its brief:

> "The appellants first assert that the lack of formal schooling is relevant in determining intent, and we note that the support of the statement that John S. Fowler quit school in the third grade and Jimmie Lea Fowler went only to the eighth grade depends upon the opening and closing statement of their counsel, plus the statement of the investigating agent that they appeared to have no great formal schooling. The applications submitted to the government for a loan (Government Exhibit No. 9 * * *) reflect the statements that Mr. Fowler had three years of high school education and Mrs. Fowler had the equivalent of a high school education."

Related to this, it is claimed that when appellants were advised of their constitutional rights at the beginning of the investigation they did not understand what they were. The investigating agent gave uncontroverted testimony that when he told appellants of their constitutional rights Mr. Fowler claimed not to understand him. The following

was then testified to by the investigating agent on cross-examination:

"A. I believe it was the first time anyone had told me after I explained their rights that they didn't understand.

"Q. Well, what was the example that you used to make him understand about it?

"A. I tried to think of the simplest example that I could.

"Q. What was that example?

"A. And I told him that neither of them were sixty-five, that had they filed a claim for Social Security benefits claiming that they were sixty-five, that that would be a false claim; and that should I come along then and ask them anything about their age they would have the right to decline to answer or give me any information pertaining thereto, because that would be a criminal offense.

"Q. And you made reference to the fourt [sic] and fifth amendments?

"A. Yes, sir.

"Q. Of the United States Constitution?

"A. Yes, sir.

"Q. Did you explain to him what the Fourth and Fifth Amendments were?

"A. I did not go into detail; I told them under the Fourth and Fifth Amendments they had the right to decline to answer or furnish me with any information.

"Q. In other words, after you gave them this example, even though Mr. Fowler has only a third grade education, or at least he quit in the third grade, he knew that you were a person who might in your work products substantiate a charge of criminal tax evasion against him, did he not; he knew that from the very beginning, did he not?

"A. I hope he did.

"Q. If he didn't, your example wasn't very good?

"A. Yes.

"Q. And you thought your example was clear, it was simple?

"A. I hoped it was made simple.

"Q. And Mrs. Fowler you thought understood, then from this first interview, that she was in danger of criminal prosecution?

"A. She offered no statement when I asked if they understood their rights; she offered no statement that she did not; only Mr. Fowler.

"Q. You were satisfied, as it is your duty to be satisfied, that they knew that criminal investigation was underway?

"A. Yes, sir."

The testimony would indicate that the agent went into much detail and made a great effort to tell appellants of their constitutional rights. It is difficult to believe that appellants did not voluntarily waive any constitutional objections in light of the agent's detailed explanation to them. Appellants were not incapable of understanding, as evidenced by their ability to operate their properties, and it is doubtful if anyone could have explained their constitutional rights to them any more clearly than did the investigating agent. No claim is made that the agent coerced the appellants, actually or impliedly, during the course of the investigation.

IV.

At one time in this prosecution the government had apparently intended to corroborate its net worth analysis with an analysis of appellants' bank account. Appellants' counsel was so advised after filing for and receiving an order requiring a bill of particulars. For some reason or another, the government did not use the bank deposit account approach as corroboration for its net worth analysis at trial and appellants now claim this was error. At the minimum, appellants feel they were entitled to an instruction, which the trial court declined to give, that the

jury was entitled to infer the bank deposit method, if used, would have been unfavorable to the government.

We do not agree. As mentioned already, the government sufficiently corroborated the net worth analysis during trial. Nowhere is there authority for the proposition that the government must prove its case by every possible method. True, the government did indicate to appellants that it intended to utilize bank deposit analysis at trial. However, it is not claimed by appellants that the failure by the government to do so was prejudicial to them. In fact, the appellants had access to the government's bank account analysis and to the documents making up such analysis. If vital to their defense, appellants could have presented this evidence themselves since the evidence was equally available to both parties. The trial judge did not abuse his discretion in refusing to give the requested instruction.[4]

V.

The final point raised by appellants which will be dealt with here concerns the admissibility into evidence of statements made by appellants to their accountant, and of extra-judicial statements made by appellants since appellants were spouses and allegedly could not testify against each other in open court. *Bouschor* v. *United States,* 8 Cir.. 1963, 316 F.2d 451, clearly indicates the reluctance by the courts to protect the client from testimony by the tax consultant. Appellants admit as much in their brief.

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[4] We concur with the following from II Wigmore on Evidence, 3d Ed., § 228, pp. 169-171, feeling that it applies to failure to produce evidence as well as to failure to call witnesses:

> "It is commonly said that no inference is allowable where the person in question is *equally available* to both parties; * * * the more logical view is that the failure to produce is *open* to an inference *against both parties,* the particular strength of the inference against either depending on the circumstances."

The husband-wife privilege does not apply, as is the case herein, where the communications were made to third parties and were thus not confidential and where the statements related to joint affairs. Here each party was the agent of the other in making the joint income tax returns, in applying for loans and in all pertinent matters involved in this case. As pointed out in McCormick on Evidence, 3d. Ed., § 84, at pages 172-173:

> "* * * Communications in private between husband and wife are assumed to be confidential unless the subject of the message or the circumstances show to the contrary. It is confidential if it was expressly made so, or if the subject is such that the communicating spouse would probably desire that the matter be kept secret, either because its disclosure would be embarrassing or for some other reasons. * * * The fact that the communication relates to business transactions tends to show that it was not intended as confidential. Examples are statements about business agreements between the spouses, or about business matters transacted by one spouse as agent for the other, or about property, or conveyances. Usually such statements relate to facts which are intended later to become publicly known. To cloak them with privilege when the transactions come into litigation would be productive of special inconvenience and injustice."

It should also be pointed out that here neither spouse was called on to testify against the other.

VI.

We have examined all of appellants' contentions with care and find no prejudicial error. Appellants were fairly tried and found guilty on substantial evidence.

This case is in all things affirmed.

Filed Nov. 4, 1965

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

September Term, 1965

No. 17,881

JOHN S. FOWLER and JIMMIE LEA FOWLER, *Appellants,*

v.

UNITED STATES OF AMERICA.

Judgment

APPEAL FROM the United States District Court for the Eastern District of Arkansas.

THIS CAUSE came on to be heard on the record from the United States District Court for the Eastern District of Arkansas, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgments and sentences of the said District Court, in this cause, be, and the same are hereby, affirmed.

And it is further Ordered by this Court that the Defendant in the said District Court, John S. Fowler, do surrender himself to the custody of the United States Marshal for the Eastern District of Arkansas, if not now in custody, in execution of the judgment and sentence imposed upon him, within thirty days from and after date of filing of the mandate of this Court in the District Court.

November 4, 1965.

APPENDIX C

UNITED STATES OF AMERICA, *Appellee,*

v.

GEORGE W. VARDINE, *Appellant.*

No. 223, Docket 27269

United States Court of Appeals Second Circuit

Argued Feb. 9, 1962

Decided July 11, 1962

* * * * * * * * * *

Before LUMBARD, Chief Judge, and WATERMAN and HAYS, Circuit Judges.

LUMBARD, Chief Judge.

The defendant was tried before Judge Foley and a jury on two counts of wilfully evading personal income taxes in 1953 in violation of § 145(b) of the Internal Revenue Code of 1939, 26 U.S.C.A. § 145(b) and in 1954 in violation of the successor section, § 7201 of the Internal Revenue Code of 1954, 26 U.S.C.A. § 7201. The government used the net worth method to prove the amount of unreported income, and the jury convicted on both counts. Judge Foley sentenced the defendant to six months' imprisonment on each count to run concurrently and fined him $2,000 on each count. On appeal the defendant raises, *inter alia,* the sufficiency of the judge's charge to the jury, the adequacy of the evidence, and numerous alleged trial errors. We believe that the charge was not erroneous and that the evidence of guilt was adequate. We find, however, two specific errors as to the admission and use of evidence. Since these were prejudicial as to the indictment year 1953 but not as to 1954, we reverse the conviction as to 1953 and affirm as to 1954.

The defendant operated an industrial laundry business under the name of Star Overall Cleaning & Supply Com-

pany (Star) in Schenectady, New York, as a sole proprietorship. Star rented and laundered overalls and uniforms. In some cases the individual employee who wore the overalls or uniform paid Star's charges and in others his employer paid. Star also rented and laundered industrial wiping cloths. The government alleges that the defendant obtained unreported income by cashing some of the checks received from Star's customers without entering them on Star's books or reporting the income on his federal income tax return.

A second alleged source of unreported income is undeclared dividends. In the years 1948 to 1953 the defendant reported no dividends, and in 1954 he reported $255 of dividends.[1] The government agent testified that according to financial reports the defendant should have received dividends in the years 1950, 1951, 1952, and 1953 in the amounts of $965, $1,674, $2,023, and $1,596, respectively.

The government submitted a summary statement of the defendant's assets, liabilities, and personal expenses,[2] which showed net worth bulges, i.e., an excess of income computed on the net worth method over income reported on annual federal income tax returns, for the calendar years 1949 through 1954. The net worth bulges for the two indictment years, 1953 and 1954, were $13,922 and $20,475, respectively, computed as follows:

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[1] Since the defendant's 1954 return was not filed until 1958, three years late, government agents were already checking his 1953 return when the 1954 return was prepared.

[2] As Judge Foley explained in his charge, such a statement is not evidence but only a convenient summary of the evidence for the jury's use.

	1953	*1954*
Taxable income computed on the net worth method	$18,148	$27,440
Taxable income reported on defendant's returns	4,226	6,964
Unreported income	$13,922	$20,475

The bulges for the four previous years, 1949 through 1952, totaled $47,725 and were admitted only as proof of wilfulness. See, e.g., United States v. Ford, 237 F.2d 57, 60, 65, 67 (2 Cir. 1956).

[1] The principal defense was that the defendant neither handled Star's books nor made out his own tax returns and that unreported rental income was due to the default of Star's bookkeeper while unreported dividends were due to the default of the defendant's attorney, and that both were without defendant's knowledge. However, Benjamin Segal, the attorney who prepared defendant's 1948 through 1953 tax returns, testified that he had asked the defendant each year whether he had received any dividends, and the defendant had replied no. The trial judge correctly left the issue of wilfulness to the jury. See United States v. Schenck, 126 F.2d 702, 706-707 (2 Cir. 1942), cert. denied, Moskowitz v. U. S., 316 U.S. 705, 62 S.Ct. 1309, 86 L.Ed. 1773 (1942).

The defendant offered two reasons why he had nonfraudulently understated his taxable income on his 1953 and 1954 returns. He had taken a deduction for $2,700 for bad debts on his 1953 income tax return. Since he reported income only as it was received, i.e., was on the cash basis, he was not entitled to such a deduction. If the defendant took this deduction erroneously but not fraudulently, the 1953 bulge would have been explained consistent with lack of wilfulness to the extent of $2,700.

The second reason was explained by a certified public accountant whom the defendant had retained to examine his books in preparation for trial. He testified that certain income and expense items had been erroneously entered. The net effect of these errors was to reduce the 1953 and 1954 net incomes shown on the defendant's books approximately $5,000 and $6,800, respectively, below their actual levels. Since the defendant's tax returns were prepared from his books of account, these errors were reflected on his tax returns. If the errors were made by the defendant's bookkeeper without defendant's knowledge, the bulge would have been explained consistently with lack of wilful tax evasion to the extent of $5,000 in 1953 and $6,800 in 1954.

Both as to the bad debt deduction and as to the bookkeeping errors, the trial judge was correct in leaving the issue of wilfulness to the jury. And it was, therefore, proper for the government to resolve these issues against the defendant in preparing its summary of the defendant's net worth. The defendant could have introduced his own summary, resolving these factual questions in his favor. Scanlon v. United States, 223 F.2d 382, 391 (1 Cir. 1955).

I.

[2] On appeal the defendant claims that he used most of the money procured from cashing the unrecorded rental checks to pay business expenses which were not deducted on his income tax returns, and thus that the unreported income and expenses offset each other. The failure of the government agent to investigate this claim was, the defendant argues, reversible error. We disagree.

[3] When a taxpayer furnishes leads which might reasonably explain his net worth bulge inconsistent with guilt, the government must investigate these leads or the trial judge should consider the taxpayer's explanations as true. Holland v. United States, 348 U.S. 121, 135-136, 75 S.Ct.

127, 99 L.Ed. 150 (1954). This leaves the burden of proof of tax evasion on the government, putting only the burden of production on the defendant. Id. at 137-139, 75 S.Ct. 127. However, if the defendant had actually expended the unreported income to pay unreported deductible expenses, he would not have had the cash on hand at the year end and his net worth would not have been increased. Thus, the defendant's claim does not tend to explain his net worth bulge.

The government had, in fact, introduced evidence of the unreported checks not as proof of the defendant's bulge, but only as proof of his intent, id. at 139, 75 S.Ct. 127, and as proof of a likely source of unreported taxable income, id. at 138-139, 75 S.Ct. 127. Rather than requiring the government to prove the negative proposition that the defendant had no other deductions, it is reasonable to require the defendant, if he wishes to disprove intent and likely source, to bear the burden of going forward when he alleges that he had additional deductions not claimed on his income tax return. See Clark v. United States, 211 F.2d 100, 103 (8 Cir. 1954), cert. denied, 348 U.S. 911, 75 S.Ct. 289, 99 L.Ed. 714 (1955); United States v. Link, 202 F.2d 592, 593-594 (3 Cir. 1953); United States v. Bender, 218 F.2d 869, 871-872 (7 Cir. 1955), cert. denied, 349 U.S. 920, 75 S.Ct. 660, 99 L.Ed. 1253, (1955); United States v. Lennon, 246 F.2d 24, 27 (2 Cir. 1957), cert. denied, 355 U.S. 836, 78 S.Ct. 60, 2 L.Ed.2d 48 (1957).

II.

[4] The defendant also contends that the trial judge erred in refusing to allow proof of defendant's accounts payable for overalls and uniforms purchased which would have reduced the defendant's net worth. The trial court was correct. Taxpayers may elect various methods of accounting for use on their income tax returns. Although a taxpayer's total taxable income over the long run should be the same regardless of the method of accounting selected,

in any given year a taxpayer on the accrual basis may have a substantially different amount of taxable income than if he had chosen the cash basis. The purpose of a net worth computation is to check the accuracy of the amount of income reported by the taxpayer. Thus, if the taxable income reported on his return is correct, and if no errors creep into the asset, liability, and expenditure figures used to ascertain successive years' net worth, the income computed on the net worth basis and that reported on his tax return should be the same. This is possible only if the figures used in computing net worth are keyed to the taxpayer's method of accounting. If a taxpayer disregards his accounts payable in reporting income on his annual tax return, i.e., reports as a cash basis taxpayer, then the government in computing his net worth in order to check the income reported on his tax return must also disregard these amounts. Whether this computation reflects net worth as accountants define it, i.e., the excess of the value of assets over liabilities, is irrelevant, United States v. O'Connor, 273 F.2d 358, 361 (2 Cir. 1959), since the government is not seeking to determine the taxpayer's true worth but rather to verify the accuracy of his income tax return for a particular year.

An examination of the defendant's tax returns and books of account discloses that he reported sales and purchases on the cash method of accounting, disregarding accounts payable for purchased overalls and uniforms. Therefore, the trial court correctly excluded proof of such payables in reconstructing his taxable income on the net worth method. See Clark v. United States, 211 F.2d 100, 105 (8 Cir. 1954), cert. denied, 348 U.S. 911, 75 S.Ct. 289, 99 L.Ed. 714 (1955); Scanlon v. United States, 223 F.2d 382, 389 (1 Cir. 1955); Leeby v. United States, 192 F.2d 331, 334 (8 Cir. 1951).

III.

The defendant raises five claimed factual mistakes in the government's net worth summary. However, on each

the trial judge properly left the conflicting testimony to the jury and properly permitted the government to base its net worth summary on its version of the facts. See Smith v. United States, 236 F.2d 260, 263-264 (8 Cir. 1956), cert. denied, 352 U.S. 909, 77 S.Ct. 148, 1 L.Ed.2d 118 (1956); United States v. O'Connor, 237 F.2d 466, 467-475 (2 Cir. 1956). Only three of these alleged errors require discussion.

[5] The government listed the defendant's cash on hand at December 31, 1948, the starting point for the government's net worth summary, at $10,000 and the cash on hand at the end of each year from 1949 to 1954 at $300. The government based its figures on an oral admission the defendant had made to a revenue agent. The agent testified that the defendant had said during an interview that before 1948 his mother had given him approximately $10,000 which he retained in cash until 1949 when he deposited the remainder in a savings account, and thereafter kept only $200 to $300 on hand. Since the defendant testified at trial that these figures substantially understated his cash on hand, there must be corroborating evidence to make a case for the jury. Smith v. United States, 348 U.S. 147, 75 S.Ct. 194, 99 L.Ed. 192 (1954); United States v. Calderon, 348 U.S. 160, 75 S.Ct. 186, 99 L.Ed. 202 (1954). The record is replete with evidence corroborating the defendant's admission that he did not have large amounts of cash on hand after December 31, 1949. The defendant periodically borrowed money to meet payrolls and other indebtedness. Furthermore, there frequently were judgments outstanding against him during this period. These facts are sufficient to permit the question of cash on hand to go to the jury. See Friedberg v. United States, 348 U.S. 142, 75 S.Ct. 138, 99 L.Ed. 188 (1954); United States v. Sclafani, 265 F.2d 408, 411-412 (2 Cir. 1959), cert. denied, 360 U.S. 918, 79 S.Ct. 1436, 3 L.Ed.2d 1534 (1959); United States v. Ford, 237 F.2d 57, 62-63 (2 Cir. 1956). See also Holland v. United States, 348 U.S. 121, 132-134, 75 S.Ct. 127, 99 L.Ed. 150 (1954).

[6, 7] The defendant testified that he owned $3,800 of securities purchased through Bache & Co. that were not shown on the summary sheet and that $3,000 of his 1952 cash inflow was due to a casualty loss and thus was nontaxable income. The government agent testified that he knew nothing of these two claims. As previously discussed, the government must investigate all of the taxpayer's reasonable explanations of his net worth bulge inconsistent with guilt or the trial judge may consider the explanations as true. Holland v. United States, 348 U.S. 121, 135-136, 75 S.Ct. 127, 99 L.Ed. 150 (1954). Thus if Vardine told the government agents about the securities and the casualty loss a sufficient period before the trial to permit investigation and they did not follow up these leads, the trial judge should have assumed their validity and required the government to reflect them on their summary statement. Scanlon v. United States, 223 F.2d 382, 388-389 (1 Cir. 1955). However, the defendant introduced no evidence that he gave these leads to the government before trial. Therefore, Judge Foley correctly left these issues to the jury.

IV.

[8] The defendant presses two claims which have merit. As proof of the balance in defendant's checking account the government introduced the amount shown on the bank's records on December 31 of each year. The defendant then introduced evidence that he had checks outstanding at the end of the years 1952, 1953 and 1954. The trial judge left it up to the jury whether to deduct these outstanding checks from the defendant's year-end checking account balance, and the government, on their net worth summary, showed the balance as it stood on the bank's books. This was error. When a cash basis taxpayer delivers his check without any limitation on the payee's ability to cash it immediately, the taxpayer is entitled to a deduction at the time of delivery. Clark v. Commissioner, 253 F.2d 745

(3 Cir. 1958). Therefore, the trial court should have instructed the jury as a matter of law to reduce the defendant's year-end checking account balance by the amount of the outstanding checks and the government to follow suit on its net worth summary statement. See United States v. O'Connor, 237 F.2d 466, 475 (2 Cir. 1956); United States v. Altruda, 224 F.2d 935, 942 (2 Cir. 1955). The amount of outstanding checks were as follows:

December 31, 1952	$ 417.
December 31, 1953	1,824.
December 31, 1954	309.

These figures would have reduced the defendant's 1953 net worth bulge by $1,407 and increased his 1954 bulge by $1,515. The government contends that since the net effect of these errors favors the defendant, there has been no harm. But since there are two separate indictment years, each must be considered separately.

[9] The other error concerns machinery and trucks. During 1953 and 1954 the taxpayer purchased new machinery and trucks for his business. As part payment of the purchase price he traded in used machinery and trucks. In four instances the trade-in allowance was larger than his adjusted basis in the assets traded-in. The Internal Revenue Code provides that such paper gains on a trade-in of old for new equipment shall not be recognized. Internal Revenue Code of 1954, § 1031, 26 U.S.C.A. § 1031; Internal Revenue Code of 1939, § 112(b) (1), 26 U.S.C.A. § 112(b) (1). Gain on the traded-in asset is postponed by taking as the basis of the new asset the basis of the old asset plus any additional cash paid. 1954 Code § 1031(d); (1939 Code § 113(a) (6). The trial judge left it to the jury whether to accept the new assets at their full selling price or at the lower price that would be computed by excluding the gain on the trade-in and permitted the government to show these assets at the higher value on their net worth sum-

mary. This was error. The government argues that the defendant "waived" his rights under § 1031 of the 1954 Code and its predecessor by erroneously taking depreciation deductions on the higher basis. But § 1031 and its predecessor are mandatory, not optional; a taxpayer cannot elect not to use them. Therefore, the trial judge should have instructed the jury as a matter of law to accept the lower basis for these assets and directed the government to alter its net worth computation accordingly. See United States v. O'Connor, 237 F.2d 466, 475 (2 Cir. 1956); United States v. Altruda, 224 F.2d 935, 942 (2 Cir. 1955). These errors caused the defendant's net worth bulge to be overstated by $592 in 1953 and $761 in 1954.

The total effect of the two errors can be summarized as follows:

	1953	*1954*
Outstanding checks	$1,407	$(1,515)*
Trade-ins	592	761
Total errors against the defendant	$1,999	$ (754)*

* Figures in parenthesis are favorable to the defendant.

While the 1953 error of $1,999 is small in comparison to the 1953 bulge of $13,922 shown on the government's net worth summary, it is impossible to tell how many of the factual questions the jury decided in the defendant's favor. In view of the other items in dispute,[3] the $1,999 error might, therefore, have accounted for the entire 1953 bulge as it was found by the jury or it might have been sufficiently material in relation to the bulge found by the jury so that we should not second guess whether they would have con-

[3] The defendant testified that the bad debt deduction on his 1953 tax return and the errors in his books in 1953 were not wilful; if believed, this would account for $7,700 of the bulge.

victed on this count. See Flemister v. United States, 260 F.2d 513, 517 (5 Cir. 1958).

The two errors did not harm the defendant as to 1954, but on the contrary, reduced the net worth bulge shown on the government's summary below what it should have been. Although the jury might have been relying on the apparent 1953 bulge, which we have found to be at least partially erroneous, as proof of wilfulness in 1954, the other proof of defendant's intent was sufficient to preclude reversal as to 1954. The fact that defendant consistently failed to report his dividend income and cashed Star's checks without recording them on the books or reporting them on his return coupled with the consistent net worth bulges for the four years preceding the prosecution years make the $1,999 error in 1953 insignificant in proving wilfulness as to 1954. Cf. United States v. Sclafani, 265 F.2d 408, 412-413 (2 Cir. 1959), cert. denied, 360 U.S. 918, 79 S.Ct. 1436, 3 L.Ed.2d 1534 (1959); Scanlon v. United States, 223 F.2d 382, 388-389 (1 Cir. 1955).

Affirmed as to 1954 and reversed as to 1953.

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

Oct. 31, 1958

No. 16781

JAMES L. FLEMISTER, *Appellant*,

v.

UNITED STATES OF AMERICA, *Appellee*.

• • • • • • • • • • •

TUTTLE, Circuit Judge.

This is an appeal from a conviction for wilfully and knowingly attempting to evade and defeat United States income taxes covering the years 1949, 1950 and 1951. The

prosecution's case was based on the net worth and non-deductible expenditures method of proof.

The principal errors asserted by appellant are: (1) that the court erred in not granting appellant's motion for a judgment of acquittal on Count One of the indictment (the year 1949) upon the ground that it was barred by the statute of limitations; (2) the court erred in not granting a motion for judgment of acquittal on the ground that the verdict was not supported by substantial evidence; (3) that the court erred in denying appellant's motion for new trial based on newly discovered evidence; and (4) that the court erred in admitting in evidence and in permitting the jury to have with it during its deliberations summaries and computations prepared by the government agents which did not accurately reflect the evidence in the case.

The indictment was returned on June 14, 1956. The income tax return for the year 1949 was filed March 13, 1950. Asserting these facts, appellant filed a motion to dismiss this count of the indictment. This motion was overruled by the court. The case subsequently went to trial, at the conclusion of which appellant renewed his attack on Count One asking a directed verdict of acquittal on the ground that any offense therein charged had been barred by the six year statute of limitations. This motion was overruled by the trial court, and the court adhered to the ruling in denying appellant's motion for new trial. In the order of denial the court stated that the court took judicial notice "of the proceedings before the Commissioner on preliminary examination which have been transmitted to the Clerk of the District Court," the court having found as to such complaint as follows:

> "Rule 5(c) of the Federal Rules of Criminal Procedure [18 U.S.C.A.] have [sic] been construed to permit the District Court to take judicial notice of the proceedings before the Commissioner on preliminary examination which have been transmitted to the Clerk

of the District Court. See White v. United States, 5 Cir., 216 F.2d 1, 4."

[1] No evidence was introduced during the trial of the case or on the preliminary motion which would toll the statute of limitations under Section 26 U.S.C.A. (I.R.C. 1954) § 6531.[1] Therefore, as the record stood when the case was submitted to the jury, the government had made no showing of facts sufficient to take the case from under the statute. As to the burden of proof in such a case see White v. United States, 5 Cir., 216 F.2d 1. In his motion for reconsideration of the order overruling the motion for new trial appellant asserted that no preliminary examination or proceedings before the United States Commissioner had taken place and no "complaint had been instituted" within the contemplation of the statute.[2] Although appellant asked the court to inquire into the facts by issuing a rule nisi, the court declined to do so and overruled the

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[1] "* * * Where a complaint is instituted before a commissioner of the United States within the period above limited, the time shall be extended until the date which is 9 months after the date of the making of the complaint before the commissioner of the United States."

[2] "As the basis for the contention that no preliminary examination or proceedings were before the United States Commissioner, the Defendant avers that on March 5, 1956 on a form entitled a complaint to a United States Commissioner, Dick D. Elliott, who designated himself as Special Agent for the Bureau of Internal Revenue, went before Honorable Ross Arnold, United States Commissioner for this Honorable Court in the Atlanta Division, and swore to a complaint. The said Dick D. Elliott then took the said complaint form, put it in his pocket and left the United States Commissioner, who did not retain said complaint; nor a copy and said Commissioner did not make any record or notation of the same nor did he follow any proceedings; make any record or do anything with reference to the alleged complaint. The next time the alleged complaint turned up was when the same was filed on May 1, 1956 in the Clerk's office of this Honorable Court. The said United States Commissioner did not file the alleged complaint in the District Court."

motion. Reference to the records of the Clerk of the District Court, of which the trial court said it took judicial notice, discloses no record of "proceedings before the Commissioner on preliminary examination," and in fact discloses nothing in the nature of a filed complaint. The only document in the record is an affidavit signed by the Internal Revenue Special Agent averring the truth of the facts which were subsequently made the basis of the 1949 indictment. It nowhere appears that this document was even "filed" in the office of the Commissioner, that a warrant or summons was issued, or that notice of its existence was communicated to Flemister until after the indictment on June 14th.

[2] We think it clear that the mere signing of this affidavit did not amount to the "institution" of a complaint before the Commissioner within the six year period. We find no appellate court decision supporting this proposition, but we think the reasoning of the District Court in United States v. Rully, D.C.D. Conn., 143 F.Supp. 283, is persuasive. This reasoning and conclusion was followed by the District Court in United States v. Jurzykowski, D.C.N.D.N.Y., 159 F.Supp. 7, 9.

[3] We next deal with the contention that the verdict was not supported by substantial evidence. We think it clear that if all of the evidence which was admitted was legally admissible, this ground for appeal must fail. Proof of repeated understatements of income, coupled with the failure to keep adequate records when viewed in light of the evidence disclosing omission of specific large items of income, and when viewed in light of the fact that appellant was a lawyer and considering the indefinite and vague testimony given by apellant on the witness stand, would clearly be sufficient to support a verdict of guilty.

This brings us then to the question whether the court erred in the admission of evidence tendered by the government to prove the existence of greater net worth than

could be accounted for by reported income on the returns filed for the prosecution years.

The first issue on this branch of the case relates to the use by the government of summaries and computations which purported to summarize testimony or documentary evidence produced in court and to translate such testimony into figures having tax significance. We do not have here the problem of using blown up charts or photostats in the presence of the jury, which was the subject of considerable discussion in the case of Lloyd v. United States, 5 Cir., 226 F.2d 9, nor have we the question as to the admissibility of such summaries and computations "in evidence" provided they are accurate, which was one of the grounds for the reversal of a conviction in an income tax fraud case in Steele v. United States, 5 Cir., 222 F.2d 628. Here appellant concedes that "where such summaries and computations accurately reflect the evidence, they of course serve a most useful purposes and can in nowise prejudice the accused." Thus the only attack made on the use of the summaries and computations in this appeal is that the summaries were incorrect and the computations made from them thus were wrong.

The incorrectness asserted by appellant is twofold. The first is that the summaries included items in the net worth computations that could be identified as items of net worth only by hearsay evidence—that is the government agent testified that he knew of certain capital expenditures because of an independent investigation he had made of records not produced in court. The second is that the summaries included only the figures testified to by the government's witnesses and thus amounted to summaries of the government's *contention* only; that they did not give any effect to testimony on behalf of the defendant, which, if believed, would reduce substantially the accused's net worth in each of the years in question.

We have carefully read the testimony relating to the alleged failure of the government to prove some of the

items by legally competent evidence, and conclude that in at least two and possibly three respects this point is well taken. As to an item of $380.50 in the summary for 1950, the court actually ruled it out on the objection of defendant that it was based on information obtained by the witness from books of Charles N. Walker Roofing Company, which were not in court. Nevertheless it remained in the summary. Another item of $430.50 listed for the year 1949 was testified to by the agent as being evidenced by two checks signed by the accused payable to one Eubanks, but the purpose for which the expenditure was made was ascertained by an examination of Eubanks' books not in court and not otherwise testified to. A third item relating to a one-half interest in some farm property listed as an asset in 1949 was proved only partially by evidence given in open court. It thus appears that items totalling a substantial amount were included in the final computations which, in the state of the proof at the time the summaries were used and exhibited to the jury, had not met the standards circumscribing the use of such schedules.

[4] The government contends that substantial accuracy is sufficient to meet the requirement of a summary. It points to errors favoring the accused and comments on the fact that no amount was added to Flemister's net worth for his and his wife's personal non-deductible expenses. It is quite possible that these items, if proved by witnesses in court and added to the summary, would have increased the net worth more than the total of the improperly proved items, but as to this we cannot speculate. Since the summary is intended to be a mathematically correct statement of what witnesses or documents have proved in the case, we cannot lightly say that the inclusion of clearly improper items in computing Flemister's net worth is not prejudicial.

[5, 6] A summary, to be admissible, we think need not give effect to the contentions of the accused. If, however, it purports to be a statement of all the evidence as to a

certain account it cannot include only items against the interest of the accused. It must, in other words, be what it purports to be, either a summary of all sworn testimony or a summary of the testimony of certain witnesses. We commented in Lloyd v. United States, supra, on the need for properly identifying the source of the figures which make up the summary. We think the summaries used in this case did not show that they represented only the testimony of government witnesses and were not a summary of all the relevant testimony, as is normally required in the use of a hypothetical question. The fact that such a summary deals only with testimony of certain witnesses or of all the witnesses on the government's side of the case can be stated on the written summaries, by the witness who identifies them and explains them, or by explanatory charge of the court when he tells the jury, as he should, that the schedules are not evidence of themselves, but merely a totalling or graphic representation in summary form of what one set of witnesses has said.

The second issue of this phase of the case arises from the fact, not testified to on the trial, but conceded by the government, for the purpose of this appeal, to be true that a $3500 liability was mistakenly omitted in the computation of appellant's net worth for the year 1951. A witness from a savings and loan association testified from his records that Flemister had a credit balance of $5,000 on deposit. This figure was added to his worth in the schedules. All parties assumed it to be correct.

After appellant's motion for a new trial had been overruled on June 5, 1958, he filed a motion for new trial on the ground of newly discovered evidence on June 13th. On the following day he filed his notice of appeal. Thereafter the trial court declined to pass on the new trial motion because of the pendency of the appeal. This newly discovered evidence is a record of the savings and loan association showing that at the end of 1951 Flemister owed $3500 to the association, thus reducing his credit balance

to $1500. This item, if proven on the trial, would have cut Flemister's alleged understatement of net income for that year by approximately one half. It is therefore a significant item.

[7] We must now determine as best we may whether the record discloses real likelihood that such errors as occurred on the trial prejudiced the accused. The government says, as to the statute of limitations point, that it parallels a case in which after a trial and conviction on several counts and a general sentence not greater than permissible for a single count, it becomes apparent that there was no evidence to support a conviction on one of the counts. In such circumstances the courts generally hold that it will be presumed that the sentence is on only the good counts. We think this is not such a case. Where, by a trial of the limitation issue separately it should have been determined, as we have done, that the year 1949 was barred, it might well have been prejudicial to the defendant for the jury to hear evidence of understatements of income and computations of underpayment of tax as to the barred year in addition to those which were properly before it.

We have already stated that we cannot lightly dismiss the claim of prejudice resulting from the inclusion of improperly admitted items in the computations of net worth and the harmful effect of not properly identifying the schedules as summaries of the government's side of the case only. In light of these matters we think the innocent omission of the $3500 item, although doubtless due to appellant's own failure adequately to analyze his own accounts, becomes too significant to overlook.

The Supreme Court, in Holland v. United States, 348 U.S. 121, 129, 75 S.Ct. 127, 132, 99 L.Ed. 150, placed a special injunction on Courts of Appeals in net worth prosecutions, when it said:

> "* * * Appellate courts should review the cases, bearing constantly in mind the difficulties that arise

when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation."

[8] We conclude, upon a careful review of the record, that justice requires that we reverse the conviction and remand the case for a new trial.

Reversed and Remanded.